

1 **WO**

2
3
4
5
6 IN THE UNITED STATES DISTRICT COURT
7 FOR THE DISTRICT OF ARIZONA

8
9 Pathway Medical Technologies, Inc., a
Delaware corporation,

10 Plaintiff,

11 vs.

12 Steven Richard Nelson, et al.,

13 Defendants.
14

No. CV11-0857 PHX DGC

ORDER

15
16 Plaintiff Pathway Medical Technologies, Inc. has filed an application for a
17 temporary restraining order (“TRO”) and preliminary injunction. Doc. 44. The motion is
18 fully briefed (Docs. 60, 62), and the Court heard oral argument on September 27, 2011.
19 For reasons that follow, the motion will be denied

20 **I. Background.**

21 Pathway develops, manufactures, and markets medical devices for the treatment of
22 arterial disease. Defendant Steven Nelson was employed by Pathway from November of
23 2008 to February of 2011. Nelson worked as a sales consultant for Pathway, focusing on
24 many of Pathway’s accounts in Arizona.

25 Following his resignation from Pathway, Nelson went to work for ev3, Inc., a
26 direct competitor of Pathway in the field of atherectomy devices. Such devices use a
27 catheter with a cutter head to remove hard and soft plaque, calcium, thrombus, and
28 fibrotic lesions from arteries.

1 Pathway claims that Nelson is violating a Confidential Information and Inventions
2 Agreement (“Agreement”) he signed while employed with Pathway. The Agreement
3 provides that for a period of one year following the end of his employment Nelson will
4 not “directly or indirectly, on behalf of myself or others (a) divert or take away any
5 customer, affiliate, or independent contractor of the company . . . or (c) attempt or assist
6 any of the foregoing.” Doc. 44-1 at 7. Pathway alleges that Nelson, on behalf of ev3, has
7 had contact with doctors and hospitals that are customers of Pathway. Pathway further
8 asserts that its sales to these doctors and hospitals have dropped since Nelson’s
9 employment at ev3 began, while ev3’s sales to these doctors and hospitals have
10 increased. Pathway asks the Court to enter a TRO that would prohibit Nelson from
11 “[c]alling on any Pathway customers in Arizona with respect to ev3’s competing
12 atherectomy devices,” “[t]raining or assisting others at ev3 with respect to sales of
13 competing products to Pathway customers in Arizona,” and “otherwise diverting or
14 taking away, directly or indirectly, any customer . . . of Pathway in Arizona, or
15 attempting or assisting any of the foregoing.” Doc. 44-2 at 2.

16 **II. Legal Standard.**

17 To obtain a TRO or preliminary injunction, a plaintiff must show that he is likely
18 to succeed on the merits, that he is likely to suffer irreparable harm in the absence
19 of preliminary relief, that the balance of equities tips in his favor, and that an injunction
20 is in the public interest. *Winter v. Natural Res. Def. Council*, 555 U.S. 7, 129 S. Ct. 365,
21 374 (2008). The test includes a sliding scale. If the plaintiff shows that the balance of
22 hardships tips sharply in his favor, he need not make as strong a showing of the
23 likelihood of success on the merits – the existence of serious questions will suffice.
24 *Alliance for Wild Rockies v. Cottrell*, 632 F.3d 1127, 1134-35 (9th Cir. 2011).

25 The Court will first address whether Pathway has shown a likelihood of success on
26 the merits or the existence of serious questions. Because the Court concludes that it has
27 shown neither, the Court need not address the other requirements for a TRO or
28 preliminary injunctive relief.

1 **III. Analysis.**

2 The Agreement provides that it is “governed by the laws of the State of
3 Washington[.]” Doc. 44-1 at 8. Pathway argues that this choice of law should be applied
4 by the Court and that the non-compete provision is enforceable under Washington law.
5 Nelson argues that the choice of law provision is invalid, that Arizona law should govern
6 this case, and that the non-compete provision is invalid under Arizona law.

7 A district court sitting in diversity jurisdiction applies the choice of law rules of
8 the state in which it sits. *Abogados v. AT&T, Inc.*, 223 F.3d 932, 934 (9th Cir. 2000).
9 Where a contract contains a choice of law provision, Arizona courts look to section 187
10 of the Restatement (Second) of Conflicts to determine whether it is enforceable.
11 *Swanson v. The Image Bank, Inc.*, 77 P.3d 439, 441 (Ariz. 2003).

12 **A. Section 187(1).**

13 Section 187(1) provides that “[t]he law of the state chosen by the parties to govern
14 their contractual rights and duties will be applied if the particular issue is one which the
15 parties could have resolved by an explicit provision in their agreement directed to that
16 issue.” RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(1). Pathway argues that
17 this provision is satisfied if the subject matter of the lawsuit is one on which the parties
18 could contract. Because parties routinely contract about an employee’s post-employment
19 obligations to his or her former employer, Pathway argues, section 187(1) is satisfied and
20 the Agreement’s choice of Washington law is enforceable. Nelson asserts that section
21 187(1) has a narrower meaning – the choice of law provision is valid if the parties could
22 have agreed in their contract to the same provisions that the chosen law would impose,
23 and could have done so under the law of the state with the most significant contacts with
24 the transaction under Restatement § 188.

25 The Court concludes that Nelson is correct. Illustrations 4 and 5 to section 187 of
26 the Restatement make clear that section 187(1) is satisfied only if the parties could have
27 agreed by contract to the terms that will be imported into their relationship through their
28 choice of law. The illustrations explain that if the state with the most significant

1 relationship to the transaction would have prohibited the parties from agreeing on
2 commissions of five percent for a trustee (because that state limits trustee commissions to
3 four percent), then the parties cannot achieve a five percent commission by choosing the
4 law of a state that would allow such a commission. In other words, the Court must ask
5 under section 187(1) whether the parties could have done by contract what they are
6 attempting to do by choice of law.

7 In this case, the Agreement's selection of Washington law would appear to have at
8 least two significant consequences: (1) Washington law adopts a liberal approach to non-
9 compete agreements, allowing such agreements to be enforced even if they are quite
10 broad and last for long periods of time, and (2) Washington allows a court to rewrite a
11 non-compete agreement to render it reasonable and enforceable if the court concludes
12 that it otherwise would be unreasonable and unenforceable. As will be explained in more
13 detail below, Arizona law does not embrace either approach. Arizona law requires that
14 non-compete provisions be narrowly drafted and no greater than necessary to protect the
15 employer's legitimate interests. Arizona cases also hold that courts may not rewrite non-
16 compete agreements to make them reasonable. Thus, the Agreement in this case attempts
17 to accomplish by the incorporation of Washington law what it could not accomplish in
18 the plain language of the contract under Arizona law. As a result, it would appear that
19 section 187(1) is not satisfied.

20 This conclusion is supported by *DCS Sanitation Management, Inc. v. Castillo*, 435
21 F.3d 892 (8th Cir. 2006), a case which held that section 187(1) was inapplicable to a
22 dispute over the enforceability of a non-compete provision. The contract in question
23 chose Ohio law, while Nebraska was the state with the most significant contacts with the
24 transaction. Because Ohio law permits a court to rewrite a non-compete agreement to
25 render it reasonable and Nebraska law does not, the Eighth Circuit held that the choice of
26 Ohio law was ineffective under section 187. *Id.* at 896. The court held that the contract
27 made in Nebraska could not accomplish by the incorporation of Ohio law what it could
28 not accomplish in its own terms under Nebraska law.

1 Arizona law comports with this holding. In *Swanson*, the Arizona Supreme Court
2 was asked to address the enforceability of a choice of law provision that would have had
3 the effect of waiving the plaintiff's right to treble damages under an Arizona statute. In
4 deciding whether the choice of law provision was valid, the Arizona Supreme Court
5 looked to what the parties could have done under Arizona law. Although the Arizona
6 statute in question authorized a recovery of treble damages, it did not prohibit parties
7 from waiving the right to such damages. The Arizona Supreme Court reached this
8 conclusion with respect to section 187(1):

9 [W]e hold that Arizona statutory law does not preclude parties from
10 agreeing by express contractual provision in a negotiated contract to
11 surrender of the right to a statutory remedy under § 23-355. Because they
12 may do so by express provision, it follows, under the law, that they may do
so by adopting the law of another state.

13 *Swanson v. Image Bank, Inc.*, 77 P.3d 439, 443 (Ariz. 2003) (footnote omitted). In other
14 words, the Arizona Supreme Court looked to Arizona law to determine whether the
15 parties could accomplish by contract in Arizona what they were seeking to accomplish by
16 choosing another state's law. Because they could, the choice of law provision was valid
17 under section 187(1).

18 Here, the parties could not, under Arizona law (the state with the most significant
19 contacts with this transaction under Restatement § 188, as will be discussed below), agree
20 to an overly broad non-compete provision, nor to a provision that allowed a court to
21 rewrite the non-compete provision to make it reasonable. Because the parties could not
22 accomplish by contract in Arizona what the Agreement seeks to accomplish by choosing
23 Washington law, the Court concludes that the choice of law provision is not valid under
24 section 187(1).

25 **B. Section 187(2).**

26 If a choice of law provision is not valid under section 187(1), the Court must turn
27 to section 187(2) to assess its validity. That provision provides as follows:
28

1 (2) The law of the state chosen by the parties to govern their
2 contractual rights and duties will be applied, even if the particular issue is
3 one which the parties could not have resolved by an explicit provision in
their agreement directed to that issue, unless either

4 (a) the chosen state has no substantial relationship to the
5 parties or the transaction and there is no other reasonable basis for the
parties' choice, or

6 (b) application of the law of the chosen state would be
7 contrary to a fundamental policy of a state which has a materially greater
8 interest than the chosen state in the determination of the particular issue and
9 which, under the rule of § 188, would be the state of the applicable law in
the absence of an effective choice of law by the parties.

10 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2).

11 Arizona appears to have the greatest interest in this matter under the factors
12 identified in section 188 because (a) it was the place of contracting between Pathway and
13 Nelson, (b) it was the place where the contract was negotiated and signed, (c) it was the
14 place of performance of Nelson's employment duties, (d) it is the location of the subject
15 matter of the contract (the doctors and hospitals to whom Nelson sold Pathway products),
16 and (e) it is the domicile of Nelson. All of these factors suggest that Arizona has the
17 most significant relationship with this case. *See* RESTATEMENT (SECOND) OF CONFLICT
18 OF LAWS § 188(2)(a)-(e).

19 Application of Washington law would appear to be contrary to a fundamental
20 policy of Arizona law in the two respects identified above. First, Arizona law does not
21 approve of broad non-compete provisions. Such provisions are "unreasonable and thus
22 will not be enforced" if "the restraint is greater than necessary to protect the employer's
23 legitimate interest." *Valley Med. Specialists v. Farber*, 982 P.2d 1277, 1283 (Ariz.
24 1999). As Pathway demonstrated in its application, Washington takes a broader approach
25 to non-compete agreements, enforcing broad and lengthy provisions. *See* Doc. 44 at 8-9.

26 Second, Arizona courts do not rewrite non-compete agreements to make them
27 reasonable. As the Arizona Supreme Court has explained, "[a]lthough we will tolerate
28

1 ignoring severable portions of a covenant to make it more reasonable, we will not permit
2 courts to add terms or rewrite provisions.” *Valley Med.*, 982 P.2d at 1286. Arizona
3 courts do not “rewrite and create a restrictive covenant significantly different from that
4 created by the parties.” *Id.* Washington law, by contrast, provides that “a trial court has
5 the power to modify a covenant so that it may be enforced to some extent, rather than
6 invalidating the covenant entirely.” *Perry v. Moran*, 748 P.2d 224, 230 (Wash. 1987);
7 *see also Armstrong v. Taco Time Intern., Inc.*, 635 P.2d 1114, 1118 (Wash. App. 1981)
8 (“a court may modify the covenant even though the offending portion is grammatically
9 indivisible from the remainder of the covenant”).

10 In a supplemental brief filed on September 28, 2011, Pathway argues that
11 Arizona’s case law against rewriting non-compete agreements does not represent a
12 “fundamental policy” of Arizona law sufficient to come within section 187(2)(b).
13 Pathway argues that Arizona’s fundamental policy is against overly-broad non-compete
14 agreements, not against rewriting such agreements, and that application of Washington’s
15 contract reformation rules would render the provision in this case reasonable and
16 therefore consistent with Arizona policy. The Court cannot agree, however, that
17 Arizona’s policy against rewriting non-compete provisions is not fundamental. The
18 Arizona Supreme Court has explained that it disapproves of rewriting because such a
19 practice might encourage employers to write overly broad non-compete provisions,
20 knowing that they will apply broadly if not challenged in court and will be rewritten to be
21 enforceable even if they are challenged. Arizona disapproves of judicial rewriting of
22 non-compete agreements because it seeks to discourage such employer practices and the
23 effect they have on employees who do not or cannot challenge non-compete provisions in
24 court. As the Arizona Supreme Court has explained:

25 For every agreement that makes its way to court, many more do not. Thus,
26 the words of the covenant have an *in terrorem* effect on departing
27 employees. Employers may therefore create ominous covenants, knowing
28 that if the words are challenged, courts will modify the agreement to make
it enforceable. Although we will tolerate ignoring severable portions of a

1 covenant to make it more reasonable, we will not permit courts to add terms
2 or rewrite provisions.

3 *Valley Medical*, 982 P.2d at 1286 (citations omitted). This looks to the Court like a
4 fundamental policy concerning non-compete provisions.

5 Because the application of Washington law to this case would appear to be
6 contrary to a fundamental policy of Arizona as reflected in the cases discussed above, the
7 Agreement's choice of Washington law likely is not enforceable under Restatement
8 section 187(2)(b).

9 **C. The Non-Compete Agreement and Arizona Law.**

10 As noted, Arizona appears to be the state with the most significant connections to
11 this transaction under section 188. For several reasons, the Court concludes that the
12 Agreement likely is not enforceable under Arizona law.

13 First, the non-compete provision contains no geographical limitation. It appears to
14 apply nationwide. Arizona courts do not enforce non-compete agreements with unlimited
15 geographical reach. *See Nouveau Riche Corp. v. Tree*, 2008 WL 5381513, at *7 (D. Ariz.
16 Dec. 23, 2008) (finding the geographic scope of a non-compete agreement overly broad
17 and therefore unlikely to be enforceable); *Liss v. Exel Transp. Servs., Inc.*, 2007 WL
18 891167, at *8 (D. Ariz. March 20, 2007) (finding the geographic scope of a restrictive
19 covenant unreasonably broad and therefore unenforceable).

20 Second, the Agreement applies to "any customer" of Pathway, whether or not
21 Nelson ever did business with that customer. The provision thus prohibits Nelson from
22 having contact even with customers with whom he had no prior relationship on behalf of
23 Pathway. Arizona courts do not enforce such provisions. *See Amex Distrib. Co. v.*
24 *Mascari*, 724 P.2d 596, 603-04 (Ariz. Ct. App. 1986) (an employer can restrict a former
25 employee's ability to service the former employer's customers only with respect to those
26 customers to whom the employee represented the employer's good will); *Nouveau Riche*
27 *Corp.*, 2008 WL 5381513, at *5 ("a non-solicitation restriction may only protect against
28

1 solicitation of those individuals with whom the [d]efendants have formed a meaningful
2 relationship”).

3 Third, the provision is broadly ambiguous. It states that Nelson may not “divert or
4 take away any customer.” These words are not defined. Does diverting or taking away a
5 customer include increasing that customer’s purchases of the new employer’s products
6 and simultaneously decreasing its purchases of Pathway products? Or does it mean that
7 the customer must be lured away entirely from Pathway? The clause also prohibits
8 Nelson from taking any steps to “attempt or assist” the diverting or taking away of a
9 customer. What kind of conduct does this prohibit? Communicating with former
10 customers? Talking to new co-workers about those customers? The provision does not
11 prohibit such conduct, but arguably could be read broadly enough to encompass it.

12 Because the non-compete provision contains no geographical limit, no limitation
13 to customers with whom Nelson had contact while employed at Pathway, and broad
14 language that could be read to prohibit a wide range of activities that may or may not be
15 damaging to Pathway, the Court concludes that it probably is “greater than necessary to
16 protect the employer’s legitimate interest.” *Valley Med.*, 982 P.2d at 1283. Under
17 Arizona law, the provision therefore is likely to be unenforceable.¹

18 **IV. Conclusion.**

19 The Court concludes that Pathway is not likely to prevail in establishing the
20 enforceability of the non-compete provision in this case. As a result, Pathway has not
21 shown a likelihood of success on the merits. Nor has it shown the existence of serious
22 questions, which require a “fair chance of success on the merits.” *Republic of the*
23 *Philippines v. Marcos*, 862 F.2d 1355, 1362 (9th Cir. 1988) (en banc) (citations omitted).
24 As a result, Pathway is not entitled to a TRO. Because this conclusion would also
25 prevent Pathway from obtaining a preliminary injunction, Pathway’s request for such an

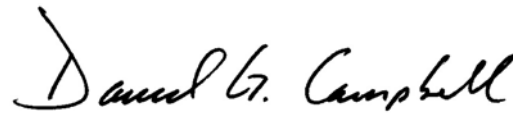
26
27 ¹ The Agreement contains a provision allowing a court to rewrite the non-compete
28 language to render it enforceable. Doc. 44-1 at 8. For the reasons explained above, the
Court concludes that such a provision is not enforceable under Arizona law.

1 injunction is also denied.

2 **IT IS ORDERED:**

- 3 1. Pathway's request to file a supplemental brief (Doc. 68) is **granted**.
4 2. Pathway's application for a TRO and preliminary injunction (Doc. 44) is
5 **denied**.

6 Dated this 30th day of September, 2011.

7
8 
9

10

David G. Campbell
11 United States District Judge
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28